Economic Outlook

Irving Trust

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For more than two years now, the performance of the economy has been characterized by modest growth in real gross national product and a sideways movement in industrial production, accompanied by intense problems in particular industries. At times the economy would provide hints of a speedup in growth, only to revert to a sluggish mode in following months. Even now, it is possible to find signs of weakness in the economy as well as positive developments. Our assessment is that the economy will continue to expand for several more years, with somewhat faster growth in 1987 than in 1986.

In late August and early September, several surprisingly positive reports on the economy were released. New orders for durable goods rose 4.3% in July, the sharpest gain in nearly two years, while manufacturing employment was reported to have risen by 19,000 in August, the first increase this year. In the most recent batch of reports, however, durable goods orders fell 2.6% in August, while the July gain was revised down to 3.4%. In addition, manufacturing employment fell by 38,000 in September, while the August report was revised to show an increase of only 1,000. In an often repeated pattern, the tone of the economy seemed to shift back and forth between negative and positive.

Despite the weakness in certain recent economic reports, some positive developments are nevertheless evident. For example, after a series of steady increases, new orders for computers and other office equipment were 51.0% higher in August than in April. The turnaround in this industry is important; investment in computers contributed a full percentage point to real GNP growth in the second quarter. The recent bottoming-out of the oil rig count, aside from being welcome news for the Southwest, also indicates that drilling activity will not be the substantial drag on GNP growth that it was earlier this year.

If the economy is to expand at a faster pace than the 2.5% annualized growth rate of the past two years, the merchandise trade balance will at a minimum have to stabilize and eventually have to narrow, first in real terms and then in current dollar terms. Despite the apparent lack of progress in shrinking the trade deficit so far, some signs are evident that dollar depreciation is indeed working the way it is supposed to in particular industries. For example, imports of paper and paperboard (on a tonnage basis) rose 23.3% from 1983 to 1984 as the dollar appreciated. During the first seven months of this year, imports fell 0.9% from the comparable period a year ago. At the same time, exports rose 16.4% during the first seven months of this year, after declining in both 1984 and 1985. The pattern is similar for wood pulp as well: Imports are now falling slightly, while exports rose 14.9% during the first seven months of this year. In addition, real exports of capital goods rose 10.7% at an annual rate in the first half of this year compared to the level in the second half of last year. Although the pickup in U.S. exports still has a long way to go if our trade deficit is to be brought under control, the benefits of the lower dollar are already visible in some industries.

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Economic Forecast

Percent Changes at Annual Rates

	Actual		1986					Forecast 1987	Actual 1984-1985	Forecast 1985-1986	Forecast 1986-1987
	I	II	III	IV	I	II	III	IV			
Gross National Product	6.2	2.6	6.9	8.0	7.6	8.6	8.2	7.2	6.2	5.7	7.1
Real GNP	3.8	0.6	3.0	4.2	3.8	4.2	3.7	2.6	2.7	2.7	3.6
GNP Price Deflator	2.5	2.5	3.2	3.6	3.6	4.2	4.4	4.5	3.4	2.9	3.4

	Actual 1986: II	Forecast 1987:III	Actual 1984-1985	Forecast 1985-1986	Forecast 1986-1987
Consumer Spending	5.2%	12.0%	7.1%	6.5%	6.7%
Durable Goods	15.3	50.1	8.5	8.2	5.9
Nondurable Goods	-0.6	5.3	4.0	3.6	5.9
Services	6.5	7.6	8.9	8.0	7.4
Business Capital Spending	--1.5	3.7	10.0	0.7	2.8
Structures	-29.8	-5.8	11.1	-7.0	-1.9
Equipment	15.8	8.2	9.4	4.7	4.9
Residential Investment	21.0	13.7	5.7	13.5	8.6
			1985	1986	1987
Change in Inventories	$14.5b.	$-13.5b.	$11.1b.	$14.1b.	$25.2b.
Net Exports of Goods and Services	$-104.5b.	$-114.1b.	$-78.9b.	$-105.6b.	$-96.9b.
			1984-1985	1985-1986	1986-1987
Government Purchases	12.0	8.7	11.2	6.3%	7.4%
Federal	14.1	12.3	13.7	4.9	8.9
Defense	19.3	12.9	10.4	8.2	9.2
Other	-0.4	10.2	24.3	-4.3	7.8
State & Local	10.7	6.0	9.3	7.5	6.3
Corporate Profits Before Tax	8.2*	1.4*	-5.3	3.4	6.9
Corporate Profits After Tax	8.9*	4.0*	-6.4	3.9	1.2
Plant and Equipment Expenditures	-0.5	1.2	9.2	-1.9	1.0
Real Final Sales#	3.4	6.4	4.2	2.6	3.2
Real Disposable Personal Income	7.1	-0.6	2.3	3.5	3.2

Economic Indicators	Recent Data July	Aug.	Sept.	Actual 1984-1985	Forecast 1985-1986	Forecast 1986-1987
Consumer Price Index**	0.0%	2.4%	n.a.	3.7%	2.2%	4.0%
Producer Price Index for Finished Goods**	-4.8	3.6	4.8%	2.1	-2.2	3.8
Industrial Production	0.3	0.1	n.a.	2.2	0.9	2.2
Retail Sales##	0.3	0.8	n.a.	6.5	4.4	6.4
				1985	1986	1987
Auto Sales (millions of units, a.r.)	10.7	12.7	16.1	11.1	11.4	10.5
Housing Starts (millions of units, a.r.)	1.82	1.82	n.a.	1.74	1.88	1.70
Unemployment Rate	6.9%	6.8%	7.0%	7.2%	7.0%	6.5%
Merchandise Trade Deficit (a.r.)	$216.4b.	$159.8b.	n.a.	$148.5b.	$170.0b.	$145.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

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#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).

$b. = billions a.r. = annual rate F = Forecast